Licensing Frameworks Team
Ofgem
10 South Colonnade
Canary Wharf
London
E14 4PU

Emailed to: licensing@ofgem.gov.uk

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Dear Licensing Frameworks team,

Consultation on Supplier Licensing Review: Ongoing requirements and exit arrangements

Drax Group plc (Drax) owns two retail businesses, Haven Power and Opus Energy, which together supply renewable electricity and gas to over 350,000 business premises. Drax also owns and operates a portfolio of flexible, low carbon and renewable electricity generation assets – providing enough power for the equivalent of more than 8.3 million homes across the UK. This is a joint response on behalf of Haven Power and Opus Energy and is non-confidential.

We are fully supportive of action to raise standards around financial resilience and customer service to support a functioning retail market. However, it is important that measures are targeted and proportionate and do not result in an excessive cost or administrative burden on market participants which will ultimately be borne by consumers.

In summary, our key points are:

- Cost mutualisation as a consequence of Supplier failures has become a seminal issue in recent times. While it would be inappropriate to mitigate the risk of such mutualisation entirely - Supplier failures (as much as successes) are a defining characteristic of any competitive market - it is an exposure that could easily have been reduced before now and should urgently be addressed moving forward.

- The long term risk of cost mutualisation could be addressed (at least in part) by Ofgem's proposed measures, but urgent changes are needed now to avoid suppliers and consumers footing the bill for further supplier failures in the nearer term. Specifically, moving from an annual in arrears payment cycle for the Renewables Obligation (RO) to a quarterly arrangement would have dramatically reduced the risk and scale of mutualisation up to now and is a legislative change that should be prioritised by the incoming Government and championed by Ofgem.

- Additionally, we believe it is wholly inappropriate and market distortive to recover costs arising in one market from an adjacent distinct market, i.e. failures of domestic suppliers and resulting shortfall in monies otherwise attributed to that market (including but not limited to governmental schemes), should not be borne by the non-domestic market and vice versa. As such, we believe mutualised costs should be attributed to and recovered from the market in which they arise, much like costs pursuant to SoLR processes are.

- We are concerned about the lack of specificity and broad application of the 'Fit & Proper' licence drafting. The proposal is unworkable in its current form and risks permanently excluding experienced individuals from senior industry roles. Additionally, suppliers will incur considerable cost to conduct the increased checks on new and existing personnel without any quantifiable consequential benefit.

- We believe portfolio splitting during the SoLR bid process has many benefits for consumers (both service levels and price) and more generally the competitiveness of the domestic and non-domestic markets. In lieu of an enduring solution, such as a domestic versus non-domestic industry 'flag', we urge Ofgem to prioritise finding an immediate way to enable portfolio splitting.

Our responses to the specific consultation questions are appended. We would be happy to discuss any part of our response with you further if it would be helpful.

Yours faithfully,

Matt Young
Group Head of Regulation
Drax Group Plc

Appendix - Consultation Questions

1. Do you think the proposed package of reforms will help to reduce the likelihood of disorderly market exits, and the disruption caused for consumers and the wider market when suppliers fail? Are there other actions you consider we should take to help achieve these aims?

We broadly agree with Ofgem's intent and direction of travel, and as such we are generally supportive of the proposed package of reforms. The proposals should go some way to mitigate supplier failures and reduce the level of costs borne by consumers. However, there are some aspects of the proposals that we do not agree with or believe there are other solutions that may bring greater benefits (e.g. introducing a quarterly payment schedule for the Renewable Obligation, RO). We have made detailed reference to these in our answers below.

2. Do you agree with the outputs of our impact assessment?

We largely agree with the outputs of the impact assessment, as far as the assessment relates to non-domestic suppliers, although we do note the assessment is primarily qualitative rather than quantitative.

3. What further quantitative data can industry provide to inform the costs and benefits of the impact assessment, particularly for cost mutualisation protections?

As we discuss in our response to Question 5, we believe moving the RO scheme to a quarterly in arrears structure would be an effective means to reduce future mutualised costs. Historic RO payment data could be sourced and used to model the likely impact of such a change, factoring in the cashflow and working capital impact of such a move.

We agree that other impacts are difficult to quantify and monetise without requesting further data from market participants, which could delay the implementation timescales of these proposals. We therefore agree that the qualitative assessment approach, that has been currently adopted, may be a pragmatic compromise.

4. Do you agree with the assumptions used to calculate the costs and benefits in our impact assessment? If not, please provide evidence to support further refinement.

Given that Opus Energy and Haven Power are non-domestic suppliers and the only aspect of the impact assessment that has been monetised relates to domestic suppliers (i.e. the protection of customer credit balances), we have no comment on the calculations and quantitative output of the assessment.

5. Do you agree with our proposed option to cost mutualisation protections? Are there other methods of implementing this proposed option? Please provide an explanation and, if possible, any evidence, to support your position.

In light of the many supplier failures that have occurred over the last few years, the majority of which have been domestic suppliers, there is a need to limit the exposure of well-funded and well-operated suppliers to the pressures of mutualised costs. We therefore support the proposals for domestic suppliers to have greater financial prudency over how they use their customers' credit balances and how they provide for their governmental scheme obligations.

Common practice in the domestic sector is for a supplier to use their customers' credit balances as working capital, and these balances are accrued because a majority of domestic consumers are on fixed direct debit terms. This practice is far less common in the non-domestic sector, where business consumers are more mindful over their expenditure and have payment terms in place that do not allow such credit balances to accrue. We therefore do not believe similar protections are warranted or necessary in the non-domestic sector.

Further, we do not think it is appropriate for non-domestic suppliers to bear the costs associated with the failures of domestic suppliers, who operate in a completely different market. Likewise, it is not appropriate for domestic suppliers and thus domestic consumers to bear the costs associated with the failure of non-domestic suppliers. The two markets have their own distinct complexities and suppliers assess risk accordingly. In the domestic market, for example, the default tariff price cap strongly influences domestic suppliers' business decisions. Therefore, as part of this package of reforms, we would call for the addition of market-specific mutualisation.

With regards to governmental scheme obligations, we believe that suppliers should be required to pay their RO liabilities more frequently so that amounts owed cannot accrue over significant periods of time. An effective means to do this would be to move the RO scheme to a quarterly payment cycle, rather than the current annual in arrears structure. A quarterly structure would limit the ability for any RO debt liability to accrue, thereby reducing the mutualised monies at the end of each RO period and ultimately minimising costs passed on to consumers. We believe that a quarterly payment structure strikes the right balance between the risk of liabilities accruing and too greatly impinging a supplier's cash flow. We have considered a move to monthly payments, but we believe that would be overly burdensome and costly to implement without any consequential benefit of dramatically reducing the risk of non-payment.

The move to a new RO payment arrangement would need to be considered carefully to allow a pragmatic transition. A couple of options we have considered as being the most equitable are:

a) move to 6-monthly then down to quarterly, staggered over a period of time, or
b) move instantly to quarterly for all future RO accruals while outstanding RO liability gets recovered pro-rata over a 12-month period (akin to a payment plan).

6. Do you agree with our proposal to introduce new milestone assessments for suppliers? Do you think the milestones we have proposed and the factors we intend to assess are the right ones? Are there additional factors we should consider to help us to identify where suppliers may be in financial difficulty?

We agree with Ofgem's rationale to limit milestone assessments to domestic suppliers, and as Opus Energy and Haven Power are non-domestic suppliers, we have no comment on the proposed arrangements.

7. Do you agree with our proposal to introduce an ongoing fit and proper requirement? Are there additional factors, other than the ones we have outlined, that you believe suppliers should assess in conducting checks?

It is right to expect suppliers to employ fit and proper individuals in roles with significant managerial responsibility, however, we have several concerns with the proposal in its current form:

- Lack of specificity: The definition provided for 'Significant Managerial Responsibility or Influence' is vague and open to considerable breadth of interpretation. This definition will be applied to

companies of differing sizes and organisational structures, each having their own difficulty in interpretation. For example, a small supplier may have a very flat structure with relatively few employees each making decisions and having influence, whereas a larger supplier with larger teams is likely to have many individuals well below senior management having significant influence albeit over a narrower remit. Without better specificity and/or appropriate guidance, suppliers are likely to adopt starkly different interpretations and/or be burdened with unnecessarily bureaucratic processes. Applying the requirement to a greater number of employees will come at a cost.

- Time limitation: As highlighted in our response to question 12, we have grave concerns around the licence drafting of 1.4e. There is no time limit relating to this licence condition which means that if someone has held a position of 'Significant Managerial Responsibility or Influence' in a company that has been subject to enforcement action, they would be excluded from taking another position of similar responsibility in the sector ever again. This is unduly restrictive and prevents individuals from working in their trained field. It also risks losing valuable industry experience and expertise.

  A supplier being subject to disciplinary, compliance or enforcement action does not automatically point to the failings of an individual occupying a senior role. On the contrary, such individuals are likely to have learnt valuable lessons which could prevent the same mistakes being made by another supplier. We suggest requiring ***"particular consideration of"*** such action, where it has occurred within the last 24 months is a more appropriate evaluation. This would ensure appropriate consideration is given to an individual's previous role without it restricting their employment opportunities indefinitely. It is also more aligned with Ofgem's new entry requirements.

- Retroactive application: We disagree with Ofgem's intention to apply the 'Fit & Proper' requirement retroactively (at least in its current form), as it is unreasonable and unworkable. We would welcome clarity on what action suppliers are expected to take, or what action Ofgem will take, if an existing employee does not meet the criteria.

- Implementation timescales: The introduction of a fit and proper requirement would entail applying new internal processes – for example, adding a 'Fit & Proper' clause to contracts (to make employees aware), a 'Fit & Proper' policy and process, including annual re-certification, and changes to other internal processes, such as disciplinary. The time needed to implement these changes will depend on the final form of the requirement, however, we don't believe 56 days is sufficient, particularly if the requirement is to apply retroactively.

8. Do you agree with our proposal to require suppliers to produce living wills? What do you think we should include as minimum criteria for living will content?

We would question the effectiveness of a living will on its own but can see it might add value to a package of measures. It is important that the content of the living will strikes the right balance by providing useful information without becoming costly and burdensome for suppliers to maintain. As a minimum, we would expect to see included; plans to mitigate the risk of excessive mutualisation of debts such as the RO, a methodology for maintaining accurate data, and ensuring the efficient handover of information such as billing contact details and open complaints in the event of a SoLR process.

However, we can see no benefit in suppliers being required to make public any of the information in their living will. Publishing the information will increase costs to comply without any corresponding benefit. We have seen no evidence to suggest customers want to see such information and, in fact, we believe that

publishing what will happen in the event of a business failing will be counterproductive and will instead instil customers with less confidence in their chosen supplier and the industry as a whole.

Without ever having compiled a living will or knowing the level of information to be contained within it, it is difficult to say whether 1-2 months is a reasonable implementation period. It is also difficult to comment without understanding if Ofgem has to approve each living will and as such if it will be an iterative process. Nevertheless, Ofgem should allow enough time to ensure suppliers' living wills are clear, comprehensive and useful.

9. Do you agree with our proposed scope for independent audits? Please provide rationale to support your view.

We support the introduction of independent audits if they are limited to customer service systems and processes. However, we do not believe it is reasonable for suppliers to be subject to an independent audit of their financial accounts where to do so would duplicate a significant cost. As such, an exemption should apply to suppliers whose financial accounts are already subject to external audits.

Moreover, audits should only be used in response to allegations of non-compliance and must be proportionate in content and scope.

10. Do you agree with the near terms steps we propose to take to improve consumers' experience of supplier failures? Are there other steps you think we should be taking?

As Opus Energy and Haven Power are non-domestic suppliers, we have no comment to make on this proposal.

11. Do you think there is merit in taking forward further actions in relation to portfolio splitting or trade sales? What are your views of the benefits of these steps? Are there any potential difficulties you can foresee?

We are fully supportive of portfolio splitting in the SoLR bid process and urge Ofgem to take steps to accelerate this positive change. The increased frequency of failed suppliers has seen a decrease in suppliers' willingness to volunteer for SoLR and we would therefore assume the competitiveness of their bids has similarly decreased. Taking on substantial portfolios through a SoLR process is putting a strain on suppliers, limiting their ability to bid into future events. Splitting the portfolio of a failed supplier would enable suppliers to bid for a segment of customers, which is likely to lead to a higher number of competitive bids than if one supplier was expected to absorb a large portfolio. Customers could benefit from transferring to a more niche supplier, e.g. one who solely supplies non-domestic customers or specialises in pre-pay meters, as well as a potentially more favourable tariff as more suppliers are eligible to bid.

We recognise that the industry requires reliable customer identifiers to enable easy splitting of portfolios, e.g. a Domestic vs. Non-Domestic flag. We urge Ofgem to not wait until a long-term solution is in place (e.g. to be delivered as part of the Faster Switching Programme) but accelerate a change so that consumers can benefit now.

The proposals around Trade Sales represent a reasonable concept but there are practical challenges to address. On what basis would the Regulator intervene? Would it, for example, just step in when a supplier is clearly in financial difficulty? Changes in legislation which give Ofgem wider powers to intervene in any

trade sale could be seen as encroaching on competition. Judging each case on its own merit also presents challenges in terms of timeframe and what objective criteria Ofgem would use.

12. Do you think our draft supply licence conditions reflect policy intent?

Operational Capability

This principle is redundant as suppliers must comply with the supply licence in order to operate regardless of demonstrating this to Ofgem. Additionally, *"demonstrate"* is vague and depending on how demonstrate is defined, could be difficult and burdensome to apply in practice.

Notwithstanding that, we firmly believe that this principle is adequately and more appropriately reflected in the enforcement process and Ofgem's associated guidelines, in so far as, if a non-compliant licensee cannot demonstrate that they had sufficient capability to comply, then they would receive a higher penalty than would otherwise have been the case. Indeed, to introduce this as an ex-ante requirement would be a departure from Ofgem's long-held position of not pre-approving compliant practices nor fettering its discretion.

'Fit and Proper'

As explained in our answer to Q7, we have grave concerns with elements of the 'Fit and Proper' drafting.

In the guidance document[1] issued alongside Ofgem's new entry requirements (implemented in July 2019), clause 4.81 states that involvement in a previous failed supply business will not automatically lead to refusal of a supply licence application, while clause 3.28 advises previous Ofgem compliance or enforcement action ***may*** be relevant. We therefore question why Ofgem's proposed requirement for the existing suppliers is worded in a way that infers a licensee ***must not employ*** a person in a position of 'Significant Managerial Responsibility or Influence' who does not meet the 'Fit and Proper' criteria.

There is a risk that 1.4d and 1.4e could unfairly restrict an individual's ethical right to employment. We would ask that *"any disciplinary, compliance or enforcement action"* is deleted from 1.4e (as set out below) as it would be impractical to implement and, more importantly, is unduly restrictive. We also suggest requiring "***particular consideration of***" the remaining stated points in 1.4d and 1.4e "***where they have occurred within the last 24 months***" is more reflective of Ofgem's policy intent and more in line with the guidance attached to new entry requirements. This would ensure appropriate consideration is given to an individual's previous role without it restricting their employment opportunities indefinitely.

> *1.4 In complying with paragraphs 1.1 to 1.3, the licensee must have regard to and take account all relevant matters including, but not limited to, whether the individual has:*
>
> *a. Any relevant unspent criminal convictions in any jurisdiction in particular fraud or money laundering;*
>
> *b. Any insolvency history, including undischarged bankruptcy, debt judgements and County Court judgements;*
>
> *c. Been disqualified from acting as a director of a company;*

[1] https://www.ofgem.gov.uk/system/files/docs/2019/07/applying_for_a_gas_or_electricity_licence_-_2019_guidance_document_1.0_0.pdf

d. Been a person with significant management responsibility or influence at a current or former Gas Supplier or Electricity Supplier which triggered a Supplier of Last Resort Event (including where they were a person with significant management responsibility or influence at that Gas Supplier or Electricity Supplier within the 12 months prior to the Supplier of Last Resort Event);

e. Been refused, had revoked, restricted or terminated, any form of authorisation~~, or had any disciplinary, compliance or enforcement action taken~~ by any regulatory body in any jurisdiction whether as an individual, or in relation to a business in which that person held significant management responsibility or influence;

Open & Cooperative Principle

It is important for Ofgem to use words that are precise and clear. The term *"cooperative"* could be defined in various ways and interpreted differently by different suppliers. Standard Licence Condition 5 already requires suppliers to provide any information upon request to Ofgem, so this requirement duplicates an existing obligation and as such is superfluous. What Ofgem would reasonably expect notice of is also very vague and open to wide interpretation.

Change of Control

The licence drafting asks for suppliers to notify Ofgem of changes related to *"any person of significant control"*; this language, again, is not precise and is open to interpretation. We would also welcome clarity on what else Ofgem require in addition to confirmation that the individual has passed a 'Fit & Proper' test.

It is also worth noting that Suppliers (and Ofgem) will need to consider whether there are any data protection issues with providing personal data to Ofgem, meaning there will be a cost to assessing the risks associated with this proposal and implementing it in a manner compliant with GDPR. While there are obvious costs, the benefits are far less obvious.

The licence drafting *around "significant changes that affect how licensee operates"* is also ill-defined, and we seek clarity on why Ofgem require such information. Ofgem's attention should be focussed on consumer outcomes, rather than a supplier's commercial and organisational decisions.

Improvements to Exit Arrangements

This topic has not been referenced in the main text of the consultation, so we cannot tell if there is a need for such an obligation. If Ofgem has reasonable evidence that there is a gap in current obligations which means that it would be possible for the appointed SoLR bidder to not follow through on the promises laid out in their proposal, then the proposed licence drafting would seem appropriate. However, if there is no evidence as to whether this is the case, or evidence of the contrary, then this obligation is unnecessary and unwarranted.

Cost mutualisation protections

We appreciate the proposal to introduce a requirement for Domestic suppliers to put in place arrangements to protect credit balances and government scheme costs is still under consideration. We expect draft licence conditions relating to this proposal to be consulted upon at the appropriate time.